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Controversy Regarding the Ready Reserve Force

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Before the
Subcommittee on Legislation and National Security
Committee on Government Operations
House of Representatives

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Mr. Chairman and members of the Subcommittee:

We are pleased to be here today to discuss certain policy and administrative matters concerning the Ready Reserve Force (RRF). At your request, we asked the involved agencies for their position on all these matters. Today, we are providing a document that outlines the positions of the Maritime Administration (MARAD), Military Sealift Command (MSC), and representatives of the maritime industry on various aspects of the RRF. My statement summarizes the information contained in this document.

The RRF is a quick response, government-owned merchant ship reserve fleet maintained by MARAD for use by the Navy in the event of a mobilization or national emergency to transport military cargo.

The Navy and MARAD disagree about important aspects of the RRF, and we are concerned about the potential adverse effect this disagreement may have on rapid sealift response capability and readiness.

The Merchant Ship Sales Act of 1946 authorized the creation and maintenance of a government-owned merchant ship reserve fleet. This fleet is called the National Defense Reserve Fleet (NDRF) and consists of ships laid up in a preservation status. It provides supplemental shipping capacity that the United States can rely on during a military or commercial shipping crisis.

In 1976, the RRF was formed by a Memorandum of Agreement (MOA) between the Navy and MARAD in recognition that the NDRF could not be activated in time to meet emergency military sealift requirements. As of October 1987, the RRF consisted of 86 ships maintained in a 5- to 20-day readiness status. DOD plans call for 120 ships by fiscal year 1992.

From fiscal years 1977 to 1981, the Navy provided most of the funding for the operation and maintenance of the RRF. After fiscal year 1981, the Navy funded all operation and maintenance expenses. RRF ship acquisition costs were funded by MARAD from fiscal years 1977 to 1983 and by Navy thereafter. Navy operation and maintenance expenditures for the RRF amounted to $220.4 million for fiscal years 1977 through 1986, while MARAD spent $4.3 million for salaries and related expenses from fiscal years 1977 to 1981. The cost of acquiring RRF ships has totaled $469.5 million -- $321.2 million spent by the Navy since fiscal year 1984 and $148.3 million spent by MARAD prior to fiscal year 1984.

Authority and Responsibility for the RRF Program

MARAD and MSC disagree over which agency is responsible for the RRF. The dispute surfaced in 1985. It involves whether the RRF is a part of the NDRF, how the RRF ships may be used, who owns and controls them, and what type of contract should be used to acquire operation and maintenance services for the RRF.

Whether or not the RRF is part of the NDRF is a primary point in the interagency debate over authority and responsibility for the RRF program. MARAD states that the Merchant Ship Sales Act of 1946, which created the NDRF, is the only statutory authority for creating and maintaining a government-owned merchant ship reserve fleet. Therefore, MARAD believes the RRF is part of the NDRF. MARAD also notes that the 1976 and the revised 1982 Memorandums of Agreements between the Navy and MARAD recognize the RRF as an element of the NDRF.

MSC states the RRF was created through an interagency agreement and has no legislative foundation. The Navy proposes to change the 1982 MOA on the basis that the RRF ships are acquired for strategic sealift purposes and are now funded entirely by the Navy. In August 1987, the Navy submitted a revised MOA to MARAD. To date no agreement on this proposed revision has been reached.

Current and Proposed Contract Types for RRF Services

MSC and MARAD disagree over the best type of contract to maintain and operate the RRF. The MOAs between MARAD and the Navy specify that RRF ships will be manned and operated through General Agency Agreements (GAAs) between MARAD and individual shipping companies. This is a common contracting instrument used in the maritime industry and is a form of cost plus fixed fee contract. The contractor receives a fixed fee in addition to reimbursement for allowable costs. MARAD awarded its GAAs on a sole-source basis from among a closed group of general agents on the basis of

technical qualifications or previous ship ownership. MARAD has used GAAs for the NDRF since its establishment about 40 years ago. MARAD states that the legislation that created the NDRF allows MARAD to use GAAs.

In keeping with the current government procurement policy of greater competition, in 1985 MARAD undertook to change its previous sole-source award process. Subsequently, at the Navy's request, MARAD changed to an open, fully competitive, firm-fixed price Request for Proposal (RFP) contract award process. In November 1986, MARAD provided more than 430 copies of the RFP to industry. Twenty-seven proposals were received in response to the RFP and, after MARAD's evaluation, 17 remain in final competition. MARAD hopes to award contracts by November 23, 1987.

Although MARAD's RFP addresses the Navy's concerns about using a fully competitive process, it does not place as much responsibility on the contractors as the Navy thinks it should. The Navy wants the contractors to be financially accountable for nonperformance. The Navy contends that congressional authorization and appropriation acts provide it the authority to direct the expenditure of funds for the RRF. Accordingly, the Navy has asked MARAD to include a contract clause that reduces payments for nonperformance. This is called an "off-hire" clause. The Navy has also asked that clauses be included that require liquidated

damages and insurance. The Navy contends that without these elements, MARAD's RFP does not place enough responsibility on the contractors.

MSC has informed MARAD that no Navy funds can be used to award RRF operation and maintenance contracts until the issues associated with the RFP are resolved. If the Navy withholds funds for current general agency agreements, as well as contract awards under the RFP, the RRF program will be severely affected.

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Mr. Chairman, while we have not performed sufficient work to recommend specific courses of action on this matter, it seems clear that to avoid the possible degradation of our nation's quick response sealift capability the administration should act expeditiously to resolve this interagency dispute. Since the issues involve both defense policy and economic considerations, the administration should consult with the Congress in resolving this matter.

This concludes my prepared remarks and I would be pleased to respond to any questions.

POSITIONS OF THE MARITIME ADMINISTRATION, MILITARY SEALIFT COMMAND, AND MARITIME INDUSTRY REPRESENTATIVES REGARDING VARIOUS ASPECTS OF THE READY RESERVE FORCE

PREPARED BY THE U.S. GENERAL ACCOUNTING OFFICE

NOVEMBER 17, 1987

PREFACE

At the request of the Subcommittee on Legislation and National Security, House Committee on Government Operations, the staff of the General Accounting Office (GAO) gathered information on the positions and views of the Maritime Administration (MARAD) and the Navy's Military Sealift Command (MSC) concerning the acquisition, operation, and maintenance of the Ready Reserve Force (RRF). The Navy and MARAD disagree about important aspects of the RRF.

The purpose of this document is to summarize the information GAO obtained from the two agencies as well as the views of a number of representatives of the maritime industry. GAO did not independently verify the information presented, nor did it perform a legal analysis of the various aspects of the disagreements concerning the RRF.

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ABBREVIATIONS

DOD	Department of Defense
DOT	Department of Transportation
FFP	Firm Fixed Price
FSS	Fast Sealift Ship
GAA	General Agency Agreement
GAO	General Accounting Office
MARAD	Maritime Administration
MOA	Memorandum of Agreement
MSC	Military Sealift Command
NDRF	National Defense Reserve Fleet
O&M	Operation and Maintenance
RRF	Ready Reserve Force
RFP	Request for Proposal
SCN	Shipbuilding and Conversion

MISSION AND ADMINISTRATION OF RRF

This appendix provides information on the establishment, mission and overall administration of the Ready Reserve Force (RRF). RRF funding, contractor performance, and applicable procurement statutes regarding the use of General Agency Agreements (GAAs) are also discussed.

ESTABLISHMENT AND MISSION

The RRF was established in November 1976 through a Memorandum of Agreement (MOA) between the Assistant Secretary of the Navy and the Assistant Secretary of Commerce for Maritime Affairs. This agreement recognized that the National Defense Reserve Fleet (NDRF) could not be activated in time to meet emergency sealift requirements. Thus, the RRF was created to provide the country with the capability to conduct quick response sealift by requiring cargo ships to be activated within 5 to 10 days of notification. This response period was subsequently changed to within 5 to 20 days of notification.

The RRF is composed of a mix of ships selected and upgraded from the NDRF and other ships acquired by the Navy or the Maritime Administration (MARAD). Ships typically acquired for the RRF include break-bulk, Roll-on/Roll-off, and ships possessing the capability of loading and discharging cargo without benefit of shore-based cranes. As of October 1987, the RRF consisted of 86 ships. Current Department of Defense (DOD) planning calls for 120 ships by fiscal year 1992.

RRF ships are berthed at MARAD's three main reserve fleet locations: James River, Virginia; Beaumont, Texas; and Suisun Bay, California. In addition, many RRF ships are berthed at other locations in the continental United States, and in Hawaii and Japan.

The 1976 MOA specified MARAD's role in the management and operations of the RRF. A subsequent MOA, signed in October 1982, changed some aspects of MARAD's responsibilities. The 1982 MOA specified that MARAD would be responsible for acquiring, upgrading, and placing ships in the RRF; maintaining the ships in accordance with MARAD and Navy standards; activating and operating the ships periodically for readiness and operational tests; and planning the mobilization of the RRF.

The 1982 MOA also specified that the Navy, commencing in fiscal year 1984, would finance ship acquisition by MARAD. The Strategic Sealift Division under the Chief of Naval Operations was

responsible for providing these funds to MARAD. However, a subsequent Navy policy change in early 1986 transferred this responsibility to the Military Sealift Command (MSC).

The Navy proposes to change the 1982 MOA on the basis that RRF ships are acquired for strategic sealift purposes and are now funded entirely by the Navy. In August 1987, the Navy submitted a revised MOA to MARAD. To date no agreement on this proposed revision has been reached.

FUNDING FOR THE RRF

Since the inception of the RRF in fiscal year 1977, operation and maintenance (O&M) funds appropriated to DOD have been used to finance all upgrades, maintenance, and operation of RRF ships. Under the 1976 MOA, the Navy agreed to reimburse MARAD for direct costs and associated overhead costs related to establishing the RRF, including all ship preparation and repairs; performing annual tests; and activating, operating, and subsequently deactivating ships.

From fiscal years 1977 to 1981, the Navy provided most of the funding for the operation and maintenance of the RRF. After fiscal year 1981, the Navy funded all operation and maintenance expenses. RRF ship acquisition costs were funded by MARAD from fiscal years 1977 to 1983 and by Navy thereafter.

From 1977 to 1983, more modern ships were added to the RRF from commercial ships traded in to the U.S. government in exchange for construction differential subsidy[1] funding to build new ships and from Navy ships that had been removed from active service. Commercial appraisers identified the trade-in value of each commercial ship, and MARAD credited the value to the owners toward the cost of new ship construction. Under this subsidy program, 34 ships with a total value of over $139 million were traded in to the RRF. In addition, MARAD accepted seven ships from their commercial owners in exchange for their equivalent value in scrap. This exchange involved old and obsolete ships for which MARAD had no further use. The scrap value of these ships amounted to $9.3 million. From fiscal years 1977 to 1981, the Navy expended $42.8 million in O&M funds for RRF ships. During this period, MARAD expended $4.3 million in salaries and other expenses for the RRF.

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[1] Construction differential subsidy payments were intended to compensate the ship buyer for the additional expense of ordering a ship from a U.S. shipbuilder rather than from a foreign builder.

From fiscal years 1982 through 1986, the Office of the Chief of Naval Operations, Strategic Sealift Division, provided O&M funds to MARAD. In June 1986, the Navy identified MSC as the single manager for strategic sealift. As a result, beginning in fiscal year 1987, MSC replaced the Strategic Sealift Division as the funding sponsor for MARAD.

Beginning in fiscal year 1984, the Congress authorized and appropriated funds to the Navy for the acquisition of RRF ships. The appropriations are included in the shipbuilding and conversion, Navy (SCN) accounts. Prior to that time, MARAD paid RRF acquisition costs. The actual expenditures of SCN and Navy O&M funding from fiscal years 1982 through 1986 are shown in table I.1. Navy O&M expenditures include three major items: maintenance, activation/ deactivation, and upgrade. In fiscal year 1986, MARAD received RRF berthing funds from MSC as part of the overall O&M costs. MARAD, however, does not consider these berthing costs as part of O&M expenses because they are not viewed as ship maintenance.

Table I.1: Expenditures of SCN and O&M Funds by Fiscal Year

	1982	1983	1984	1985	1986	Total
			(millions)			
SCN (Ship acquisition)	$ -	$ -	$83.0	$31.0	$217.2	$321.2
O&M	12.2	14.7	29.9	53.1	67.7	177.6

ADEQUACY OF CONTRACTOR PERFORMANCE

According to MARAD, contractor performance has been excellent under GAAs. MARAD states that a number of actions contribute to successful activations, but the primary one is that the general agents and MARAD personnel work as a team to activate the ships.

From the inception of the RRF program to October 1, 1987, a total of 37 RRF ship activations, using 11 general agents, had been completed. Twenty-one of these activations were on a "no notice" basis and required successful activation within 5 or 10 days of notification.

According to MARAD, the only ship which failed to meet an activation deadline under a general agent agreement was the SS President by American President Lines and this was due to latent defects in the ship. Even though the SS President was classified as a 5-day RRF ship, it took American President Lines 71 days to complete the activation. MARAD attributed the failure to the ship's age and poor condition, citing severe deterioration between the time of its

first successful activation in July 1981 and the January 1985 attempt. Moreover, MARAD claimed it was short on maintenance and repair funds between these times because of the larger than expected number of RRF ships acquired.

During the activation, the SS President encountered boiler problems and its force draft fans failed. The ship was towed back to port, and the crane was found to be defective, even though it had passed inspection by American Bureau of Shipping inspectors. After repairs, the ship was successfully retested at sea, but MARAD decided to drop the SS President from the RRF.

On March 7, 1985, the Director of Strategic Sealift, Chief of Naval Operations, testified before the Subcommittee on Seapower and Force Projection, Senate Committee on Armed Services, that of the 10 ships activated since 1982, only 1 ship--the SS President--had failed.

MSC believes that the following four RRF ships also failed to be acceptably activated in the required time frame and should also be considered instances of contractor nonperformance:

--SS Washington. This 5-day RRF ship missed activation by 12 hours, 52 minutes on a "no-notice" activation to test its seaworthiness. Had the activation, which occurred in 1981, been for an exercise, the ship would not have been accepted due to problems with its cargo handling cranes, high salinity in the boilers, numerous leaks, and an operational restriction imposed by the U.S. Coast Guard.

--SS Lone Star Mariner. This 10-day RRF ship, which was activated in 1982, met the activation schedule but was not accepted because of patching on a tank top and deteriorated external electrical wiring. The ship was scrapped in November 1985.

--SS California. This 5-day RRF ship, which was activated in 1983, met the activation time, but operational control of the ship was not accepted for another 3 days due to expired U.S. Coast Guard certificates.

--SS Pioneer Crusader. This 10-day RRF ship missed a "no-notice" activation deadline by 3 hours. During the 1984 activation, the ship was tendered in 7 days but was not accepted due to incomplete repairs, tests, and an unsigned U.S. Coast Guard inspection certificate.

MANAGEMENT OF RRF SHIPS VERSUS MSC'S SHIPS

MARAD has managed RRF ships using GAAs. Under these agreements, general agents receive a fixed fee in addition to allowable costs incurred. All RRF ships are government owned. At the present time, 80 of the total 86 RRF ships are being maintained under agreements with 11 general agents. The Navy manages MSC ships using firm-fixed price contracts. Under these contracts, a firm-fixed price is agreed upon for operating and maintaining MSC ships with the contractors bearing the cost risks if a ship cannot perform. MSC would like MARAD to manage RRF ships in a manner more similar to MSC ships, many of which are privately owned. This disagreement is discussed in detail in appendix III.

APPLICABLE PROCUREMENT STATUTES ON USE OF GENERAL AGENCY AGREEMENTS

MARAD says its authority for use of GAAs in administration of the NDRF and the RRF subcomponent is found in section 207 of the Merchant Ship Sales Act of 1946, as amended (50 U.S.C., App. 1744). The act endorses the use of instruments available to private corporations and states that the contracting instrument to be used is determined by the Secretary of Transportation through MARAD. MARAD said that for about 40 years, GAA authority has appeared as formal, published regulations of MARAD and that such authority has never been questioned by DOD.

Neither MARAD nor MSC knows of any other government agencies that use GAAs.

Applicability of Competition in Contracting Act

MSC states that MARAD, in the past, has awarded GAAs on a sole-source basis without obtaining maximum practical competition as required by the Competition in Contracting Act of 1984. MARAD states that it is legally exempt from following this act by 40 U.S.C. 474(16). But, the Department of Transportation (DOT) and MARAD state that they recognize the wisdom of competition and pursue it to the maximum extent possible.

The Navy believes that MARAD has no statutory authority for the RRF. It states that the RRF was established through the 1977 DOD authorization and appropriation acts and that MARAD's authority and responsibility for the RRF are limited to those functions listed in the 1982 MOA. The Navy does not believe MARAD is exempt from the requirements of the Competition in Contracting Act when contracting for the RRF and the NDRF.

APPENDIX I

The Navy states that it is important for the government to ensure that the contractual instrument combines maximum readiness, contractor accountability, and cost effectiveness. The Navy contends the GAA insulates a contractor from all responsibility or liability for providing the Navy with the levels of readiness required by the agreement. According to the Navy, the use of firm-fixed price contracts awarded in accordance with the Federal Acquisition Regulation would place an "appropriate" level of responsibility for readiness on the contractor. This is the same manner in which the Navy has operated its fleet of about 130 commercial ships.

DISAGREEMENT OVER AUTHORITY FOR THE RRF

The Department of Transportation, acting through MARAD, and the Department of the Navy, acting through MSC, disagree about which agency has responsibility and authority for the RRF. The agencies disagree about whether the RRF is part of the NDRF, how a prepositioned crane ship can be used, and who owns newly acquired RRF ships.

MARAD'S POSITION REGARDING THE RRF

MARAD believes that it alone has authority to maintain the RRF and that, in exercising that authority and the concomitant authority to approve use of such ships to carry defense cargoes, it is subject to various congressional limitations on competition with commercial ocean carriers.

MARAD maintains that section 11 of the Merchant Ship Sales Act of 1946, as amended (50 U.S.C., App. 1744), is the only statutory authority supporting the creation and maintenance of a government-owned merchant ship reserve fleet (see app. V.). This fleet is designated the National Defense Reserve Fleet and all ships placed in it must be preserved for national defense purposes or the movement of commercial cargoes during times of national economic crisis. MARAD states that it is the sole agency responsible for balancing the commercial maritime interests and national defense maritime considerations. Thus, the NDRF has both a defense and a non-defense function, and the act vests responsibility for the administration of the single merchant reserve fleet in the Secretary of Transportation. MARAD further states that the dual purposes of the NDRF have been repeatedly recognized by various authorities, including DOD and the Congress.

The RRF was created through a MOA between the Navy and MARAD in 1976 in recognition of a "mutual" interest and responsibility in the joint establishment, maintenance, and control of an RRF as an element of the NDRF maintained by MARAD. MARAD stated that at no point, before or after the establishment of the RRF, was the fact that the RRF was an integral part of the NDRF discussed, much less challenged. It is MARAD's position that this also was the understanding of the Congress because various committee reports describe the RRF as a "subset" or "component" of the NDRF. It believes this is true whether funds for the RRF are appropriated to MARAD or the Navy.

During congressional hearings before MARAD's fiscal year 1987 authorization, possible amendments to the law (section 11 of the 1946 act) were explored to specify that the RRF was part of the NDRF. MARAD maintained that this was an unnecessary change because it was responsible for the NDRF under existing law and that the RRF

was a subunit of the NDRF. A "Statement of Administration Policy" from the White House to the Congress advised that this amendment was unnecessary. Consequently, section 11 was not amended.

MSC believes that its statutory authority to administer the RRF is based on the Navy having received appropriations to purchase merchant ships for a reserve fleet and that an appropriation implied an authorization for MSC to administer the ships purchased. MARAD states that, as a general matter, it does not dispute the fact that an appropriation implies an authorization, but that the appropriation and authorization language must be reviewed to determined what was intended. Consequently, the DOT Office of General Counsel examined the DOD appropriations and authorization acts for fiscal years 1984, 1985, and 1986. These years were selected because they followed the 1982 revision to the MOA in which the RRF is clearly identified as a part of the NDRF.

In these acts, the only applicable reference DOT found was to the "strategic sealift program" (the DOD program name for the RRF), without explanation. In the absence of specific language in these appropriations and authorization acts, MARAD believes that the program was approved and understood by the Congress to be managed by MARAD. According to MARAD, the 1982 MOA was a "contemporaneous expression" of the program of which the Congress was aware. When the fiscal year 1984, 1985, and 1986 appropriations and authorization acts were enacted, the MOA clearly characterized the RRF as part of the NDRF. Thus, MARAD maintains that DOD has no authority to maintain a fleet of reserve merchant ships.

MSC'S POSITION REGARDING THE RRF

MSC states that acquisition and conversion of merchant ships for the RRF have been funded by the Navy as authorized by the Congress through the DOD appropriations acts. Specific funding for acquisition of ships for the RRF is provided by the Congress in the Navy's shipbuilding and conversion appropriation. Additionally, the Navy finances the operation and maintenance of the RRF with its O&M appropriations. MSC states that inherent in the appropriation of funds to any executive agency is the accountability of that agency for the proper expenditure of those funds. Therefore, since the Congress has authorized Navy funding for the acquisition, operation, and maintenance of RRF ships, MSC argues it must have "plenary authority" to make decisions necessary to achieve the most efficient expenditure of that funding, which now exceeds $200 million per year. MSC maintains that a program of such magnitude demands that the Navy appropriately allocate risk and cost management.

MSC believes that the term Ready Reserve Force was initially meant to distinguish RRF ships from NDRF ships. It is MSC's position that the RRF was never intended to be a functional element of the NDRF. MSC states that these two groups of ships are funded separately, operated separately, and were established for separate purposes.

MSC maintains there is no statutory basis for the RRF and the RRF exists because DOD decided to allocate a portion of its annual O&M and SCN appropriations to acquire and maintain ships for the RRF. In contrast, the NDRF has roles in national defense and non-defense (economic) crises. MSC concludes that it needs general authority to manage the RRF since this force was established specifically to satisfy military strategic sealift requirements and is dedicated solely to national defense. MSC supports its position by noting that the Congress, in legislation affecting DOT, has recognized that the Navy has the authority to make decisions affecting the acquisition of ships for the RRF, as distinguished from the NDRF.1

Additionally, MSC maintains that it can purchase, and it has, ships for strategic sealift using Navy contracting officers and that it can execute Navy contracts to operate and maintain these ships. MSC states that it is illogical to conclude that the Navy surrenders jurisdiction over the RRF every time MARAD contracts for maintaining the RRF since the Navy could retain this function by using its own administrative capability.

MSC further states that MARAD contends that the RRF should be part of the NDRF because it "will continue the civilian control of merchant shipping required to satisfy the priorities involving military operations and general economic support of the private sector under both normal and contingency situations." MSC believes this position is contrary to the uniquely military purpose of the RRF and its Navy funding, as well as to the 1976 and 1982 MOAs that place primary decisionmaking authority for the RRF with the Navy. MSC cites the Merchant Ship Sales Act of 1946 as another reason why NDRF ships cannot be used for any purpose whatsoever, except during a period when ships can be requisitioned under title 46, section 1242 of the United States Code. This section requires (1) a Presidential proclamation that the security of the national defense makes it advisable or (2) a national emergency declared by the

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1 See Miscellaneous Changes to Laws Affecting the Coast Guard, Section 13, Public Law 99-307, enacted May 19, 1986; 100 Stat. 448. This law provides that before certain vessels may be sold to a foreign purchaser, the Secretary of the Navy may acquire the vessels for the RRF or the Secretary of Transportation may acquire the vessels for the NDRF.

President. Since a Presidential proclamation is not in effect, MSC states that "there is no authority within the Merchant Ship Sales Act of 1946 itself" to withdraw ships from the NDRF. Thus, MSC believes if the RRF is viewed as a part of the NDRF, it cannot use the ships for strategic sealift contingencies without a national emergency or Presidential proclamation. MSC believes this is counter to a fundamental reason that led to establishing the RRF in 1976, that is, to meet military requirements for a rapid sealift capacity that the NDRF and U.S. merchant fleet could not meet. MSC states that in 1976 the national emergency proclaimed by President Truman on December 19, 1950, was still in effect, so ships could be freely withdrawn from the NDRF. This state of national emergency was terminated by law in September 1978. For reasons that MSC states are not clear, the 1982 MOA did not contain any provision reflecting this change in law.

USE OF AN RRF CRANE SHIP

The Navy has requested that MARAD permanently transfer a specialized crane ship--the SS Grand Canyon State--from the RRF to MSC's active fleet and preposition it in the Indian Ocean with a field medical facility aboard. MARAD strongly objects to this proposal.

MARAD's position is directly linked to its belief that RRF ships are not Navy owned and their use is governed by statutory authority given to MARAD. MARAD believes that these ships may be activated for exercises to determine if readiness requirements can be met and that it cannot support call-ups made for purposes other than ship testing or supporting naval exercises.

MARAD does not question the strategic soundness of prepositioning a crane ship in the Indian Ocean area, but believes the storage of medical equipment aboard the ship is a modification of its special capability. In addition, medical equipment has been stored on a commercially chartered U.S. flag ship in that area and this action would compete with or replace such commercial ships. Furthermore, MSC notified MARAD that it is considering the use of a civil service crew to operate the ship. MARAD believes that this proposal would break a very effective contract with a commercial firm to train crane operators and maintain, activate, and operate the ship.

The Navy maintains that it owns the Grand Canyon State and thus the ship can be used for what it considers an appropriate mission. It also contends that this ship has a unique cargo lifting capability needed to satisfy a military requirement. Furthermore, the Navy believes that the prepositioning of hospital equipment aboard this ship is a prudent use of an otherwise empty ship and sees no

difference between this type of storage and ashore storage. The Navy also believes a civil service crew should be used if that is the most cost-effective method.

NAVY'S PROPOSED CHANGES TO SHIP DOCUMENTS FOR NEWLY ACQUIRED SHIPS

During fiscal year 1987, the Navy terminated the yearly transfer of RRF ship acquisition funds (SCN) from the Strategic Sealift Division of the Chief of Naval Operations to MARAD. Under a new procedure, MSC purchases ships for the RRF directly from their commercial owners. MARAD objects to this procedure and states it is "concerned that such action is inconsistent with the Administration's policies and the testimony and submissions to the Congress."

In addition, the Navy has advised DOT of its intention to place nine newly acquired ships in its own fleet of reserve commercial ships by adding them, as public vessels, to a laid-up segment of the MSC fleet.

DOT's position on these ships is expressed in a memorandum dated August 28, 1987, from the Deputy Secretary of Transportation to the Commandant of the United States Coast Guard. In part, it states that DOT has repeatedly asked the Navy for an explanation of its legal authority to maintain its own fleet of reserve commercial ships. However, despite assurances that such an opinion would be provided, DOT never received one. Further, DOT's Office of General Counsel examined the issue and found no such authority. On these bases, DOT concluded the Navy does not have the authority to maintain a fleet of reserve commercial ships and does not have authority as purported owner of such ships. This memorandum requests that no action be taken or agreed to by the U.S. Coast Guard with MSC that would allow the ships being acquired for the RRF to be documented in any manner that differs from past practice. DOT stated that, over the past 10 years, RRF ships have been documented with the U.S. Coast Guard as being owned by the United States as represented by the Secretary of Transportation acting by and through the Maritime Administrator.

MSC and the Assistant Secretary of the Navy (Shipbuilding and Logistics) believe that the RRF is not a jurisdictional element of the NDRF and that the Navy, acting through MSC, should be the owner of record of RRF ships acquired with Navy funds. It is also the Navy's position that the RRF was established in DOD's 1977 authorization and appropriation acts solely to provide rapidly available strategic military sealift in crises, contingencies, or during full mobilization. MSC believes that as the single manager for strategic sealift it should manage this force separately and distinctly from the NDRF.

APPENDIX II

The Navy also believes that the provisions of the Merchant Ship Sales Act of 1946 have no applicability to the purchase of ships for the RRF from funds specifically appropriated to DOD for this use. It believes that the act deals with ships "owned" by DOT and that since DOD buys the ships, they are owned by DOD, not DOT. Also, the Navy maintains that ships will acquire "public vessel" status by virtue of being owned and operated by the government and thus their status would be the same, regardless of whether MARAD or MSC is reflected as the owner in the ships' documents.

DISAGREEMENT OVER TYPE OF CONTRACT FOR THE OPERATION AND MAINTENANCE OF THE RRF

During the past few years, MARAD and MSC have disagreed on the overall administration of the RRF. The Navy is particularly concerned about MARAD's use of GAAs to obtain RRF operation and maintenance services. Aside from the issues of competition and cost versus firm-fixed price contracts, the Navy asserts that MARAD lacks sufficient controls over contractor costs and that the government is not adequately protected against nonperformance by a contractor.

MARAD believes these assertions are inaccurate and additional costs are associated with MSC's approach for acquiring these services. Nonetheless, it attempted to address the Navy's concerns by changing from a GAA to a firm-fixed price type contract with certain costs on a reimbursable basis. The RFP for such a contract, however, did not fully incorporate the Navy's preferences on the issues of contractual relationship, off-hire (reduction in payment for periods of nonperformance), insurance, and liquidated damages; and the Navy objected to it.

TYPE OF CONTRACTS ADVOCATED

MSC and MARAD disagree on the type of contract to acquire services for the operation and maintenance of RRF ships. MARAD, which believes it has been given authority by statute to determine the contract type, uses GAAs with shipping companies to obtain such services. Its use of GAAs was not questioned until 1985. MARAD believes this practice, which is commonly used in the maritime industry, is the most expedient and cost-effective method of contracting for these type services. On the other hand, MSC contends that it has the authority, through congressional authorization and appropriations acts, to direct the "proper and effective" expenditure of funds for the RRF. It believes that firm-fixed price operating contracts would be more cost effective than GAAs if increased readiness is considered.

MARAD'S AWARD OF GAAS

In the past, MARAD's GAAs were awarded on sole-source basis with the awardee selected from a closed group of general agents on the basis of technical qualifications or previous ship ownership. Under the general agent concept, a contractor receives a fixed fee in addition to the actual costs it incurs. According to MARAD, the contract is controlled by the government and funds are only expended for the work authorized by the government. The agreements are effective until terminated, upon 30 days notice, by either the

general agent or the government. Currently, 80 of the 86 RRF ships are being maintained under agreements with 11 general agents. According to MARAD, the six ships without agents are small break-bulk ships that the Navy plans to downgrade and place in the NDRF.

GAA rates

In 1977, when GAAs were initiated for RRF ships, the agent received an annual retainer fee of $6,000 a ship. That amount was basically the profit realized by the general agent for acting on behalf of the government in providing operation and maintenance services for RRF ships. Under the agreement, the agent also received out-of-pocket expenses, lodging, travel, salaries, fringe benefits, etc; for personnel operating and maintaining the ships, plus a daily administrative expense of $35 for each person assigned to the ship. Upon turning a ship over to the general agent for activation or operation, the agent received a daily management fee of $200, plus out-of-pocket expenses for persons directly involved with the ship's activation.

However, in 1984, with bids on the Keystone State (a unique multi-crane ship), three T-1 tankers, and the Southern Cross (a break-bulk ship), agents began seeking higher amounts for daily costs. Currently, the standard rates are $125 a day for laid-up ships and $300 a day for active ships. These rates, however, may vary because of unique ship characteristics. For example, the daily rates to manage three tankers located in Hawaii and Japan are $120 for laid-up ships and $160 for active ships, while the laid-up and active rates for the Keystone State are $175 and $390, respectively.

For fiscal years 1976 through 1987, MARAD provided $245.8 million to general agents. Of this amount, $6.4 million was for retention fees and $239.4 million was for operation and maintenance services. During this period, services were provided for an RRF force level that ranged from 16 to 76 ships.

Review of agent's cost submissions

MARAD officials cited specific procedures they use to review an agent's cost submissions and to safeguard against agent cost abuse. Funds are monitored closely by MARAD and withdrawals involving payments directly to the agent require the signature of both the agent and a MARAD contracting official. Also, a contracting officer's technical representative is assigned to monitor performance under the GAA. According to MARAD, general agents request an advance of funds monthly and provide an explanation of their proposed uses. MARAD reviews the request and grants approval if it coincides with the maintenance plan for the ship. At the end

of the month, the general agent submits cost reports for all funds expended, which MARAD reviews for deviations from the forecast and for the proper assignment of funds.

The DOT Office of the Inspector General periodically audits the accounts of general agents. These audits normally occur after a major project such as an activation or deactivation. If a cost is found to be excessive or otherwise not allowable, it is disallowed or adjusted. If excess funds have been advanced, the general agent returns the funds to MARAD. Recent Inspector General audit reports on general agent cost submissions show that, in most instances, any cost adjustments recommended were accepted and the agent reimbursed the government. Reports concerning 11 general agents and various audit periods between May 1985 and March 1987 show individual audit report adjustments ranging from zero to about $245,000. The total actual disallowances were about $482,000, and about $290,000 has been recovered. According to MARAD, the remaining $192,000 either has been supported by the agent or is pending a review by MARAD officials.

According to MARAD, under the current RFP for a firm-fixed price contract (with certain portions reimbursable), the review procedures would change. The fixed-price portion would only be paid after MARAD verified completion of work and the payment could not exceed the negotiated fixed price. For reimbursable payments, MARAD would require advanced approval of orders. Reimbursable items would include such things as the acquisition and transportation of repair parts, testing of hydraulic and lube oil systems, and maintenance briefings. In addition, MARAD would verify all invoices for reimbursable items and receipt of all reimbursements.

NAVY'S OBJECTIONS TO THE GAA TYPE CONTRACT

In objecting to GAAs, the Navy raised the issues of inappropriate pricing and business arrangements and MARAD's inability to enforce contractor performance and accountability. The Navy states that the operation and maintenance of RRF ships are not complicated and that the minimum needs can be described in a carefully developed performance of work statement. Consequently, the Navy believes that the appropriate contract type is a firm-fixed price contract under which the contractor has full responsibility for completing the contract at the agreed upon fixed price. The Navy uses firm-fixed price contracts for the operation and maintenance of its cargo ships, which are similar to those in the RRF.

The Navy further contends that under the GAA, the general agent is rarely held accountable for his actions and is not held liable when performance is not carried out. In contrast, the Navy states a

APPENDIX III

firm-fixed price contract links performance to price and the contract price is reduced whenever a contractor fails to perform in accordance with the contract performance work statement.

MARAD states that the Navy's comments concerning the GAA form are based on a misunderstanding of the agreement used for the RRF. The traditional GAA, which is published in title 46, part 315 of the Code of Federal Regulations, is used for other NDRF ships, while a new GAA, which was devised for the RRF in 1977, is used for all RRF ships. MARAD states that the new GAA carefully defines allowable and nonallowable costs and allows for termination at any point with no additional cost. MARAD believes this approach is more beneficial to the government than the normal process of terminating for default or convenience.

The GAAs used for the RRF retain the liability and indemnity clauses that limit the contractor's monetary liability. MARAD states it is not realistic to impose insurance requirements in wartime or emergency situations because it would merely add costs that the agent-contractor would pass on to the government. It contends that the standard of willful or gross negligence and the contractor's monetary liability ceiling of $500,000 in the RRF agreement recognize that the application of normal, peacetime standards of operations in crisis operations is not viable.

MARAD BELIEVES RRF OPERATING COSTS WILL INCREASE

MARAD contends that using a contractor versus a general agent will increase contract costs from about $100 million to $187 million over the 5-year contract period for 75 ships. According to MARAD, under the firm-fixed price contract approach, it will also incur additional administrative costs related to:

--Increased contract administration staff. An additional two or three employees would be needed to process an additional 1,000 modifications or work orders.

--Reduced flexibility. MARAD cannot increase or decrease work contracted for, due to budgetary reductions or increases, without incurring administrative costs related to contract termination for convenience or prolonged negotiations.

--Increased requests for work approval. Contractors will demand that MARAD fund and approve all maintenance work requested or will advise that they are not responsible for timely activations.

MSC officials stated that they expect contract costs to increase during the transition from GAAs to firm-fixed price contracts. They do not, however, believe the increased costs will be excessive but are willing to pay for the assurance of readiness.

MARAD'S RFP AND
MSC'S REACTIONS

MARAD responded to the Navy's concerns by revising its solicitation for general agents from a sole-source, cost plus fixed-fee approach--the GAA--to a fully competitive firm-fixed price RFP. The RFP initially covers the operation and maintenance of 70 RRF ships which are divided into 16 groups. These groups were established on the basis of geographic dispersion and commonality of ship design type. Although a firm may bid on all of the groups, a firm cannot receive a contract for more than two groups. In addition, MARAD established an Office of Acquisition staffed with personnel knowledgeable about DOD's contracting procurement policy to improve RRF administration. According to MARAD officials, they and MSC differed on 16 issues concerning the RFP. MARAD incorporated MSC's recommendations on 12 of these issues. The remaining four unresolved areas are:

Contractual relationship - MARAD's RFP provides for a ship manager that is responsible for the overall management of the RRF ship. Except in the operational phase of the RRF program, the ship manager's accountability for performance is judged on a case by case basis. MSC believes this type of contractual relationship places an insufficient amount of liability upon the ship manager to fulfill the contract. MSC believes the RFP should require contractors to be held financially accountable for nonperformance in all phases of the RRF program.

"Off-hire" clause - This clause provides for the reduction of payments under the contract by a specific amount for each day a ship does not fully meet operational requirements. MARAD's RFP institutes this during the operational phase, but MSC wants this clause to be effective throughout the contract.

Insurance - MARAD believes that a contractor's liability during a wartime or national emergency situation should not be more than the normal $500,000 for gross negligence. Therefore, under MARAD's RFP the government is self-insured. MSC would prefer that the contractor obtain liability insurance.

Liquidated Damages - Under MARAD's RFP there are no provisions for liquidated damages. MSC wants the contractor to pay the government $10,000 a day if the ship is not fully operational by the fourth day of notification.

The commander of MSC contends that the MARAD RFP still closely resembles general agency agreements and has prohibited MARAD from using Navy funds for the operation of the RRF by GAAs issued after November 20, 1986. MARAD is continuing to operate and maintain the RRF under existing GAAs.

RFP status

Without the concurrence of MSC, MARAD issued the RFP to 434 firms. Of these, 27 submitted proposals. After MARAD's initial evaluations, 17 proposals remained in the final competition. Best and final bid offers were received on October 15, 1987, and MARAD expects to award contracts before the November 23, 1987, expiration date of the offers. However, contract awards are contingent upon Navy or other sources of funding.

MARAD contends that the RRF program would be severely affected if the Navy withholds funds for contract awards under the RFP as well as current general agents. Without a contingency plan for manning and outfitting the RRF ships, the activation time period requirements will not be met. MARAD would need to obtain additional appropriations to retain the current agents and maintain the ships in a state of readiness. In addition, MARAD believes it may be subject to bid and proposal preparation cost claims totaling about $6.8 million from those firms remaining in the competition.

According to a MARAD contracting official, if a contract is not awarded by November 23, 1987, MARAD will have to continue using temporary GAAs and request an extension on the offers provided by offerors. This official believes that industry may deny the extension of time in an effort to force resolution of the four RFP contracting issues between MARAD and MSC.

APPENDIX IV

INDUSTRY'S VIEWS ON CONTRACTS ADVOCATED BY MARAD AND MSC

Some maritime industry officials believe the MSC contracting approach places too much risk on the contractor and, as a result, it will be more expensive, eliminate many highly qualified contractors, and encourage marginal contractors, who may not be able to perform in national emergencies, to submit proposals. Three items of particular concern are the issues of "off-hire" liability, insurance liability, and liquidated damages.

An industry official provided us a comparison of how matters related to these risk issues are treated in the MARAD/RFP and an MSC contract for a fast sealift ship (FSS). (See table IV.1 for the comparison). According to this official, the current RFP clauses shown in table IV.1 except for "off-hire" liability during operations (Phase O) are generally acceptable but the contract provisions proposed by MSC are not.

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Table IV.1: Comparison of treatment of risk issues for selected contract types

MARAD General Agent	MARAD Ship Manager (Current RFP)	MSC Contractor (FSS contract)
OFF-HIRE	OFF-HIRE	OFF-HIRE
No liability	All Phases except Phase O1, are judged on a case basis. Remedies may include: -Performance by ship manager for his own account. -Performance by Government and charged to the ship manager. -Reduction of per diem. -Termination for default. In Phase O, contract price is reduced by number of total days lost multiplied by the appropriate per diem.	Contract price reduction by amount equal to the total number of days lost multiplied by the appropriate per diem rate.
P&I INSURANCE	P&I INSURANCE	P&I INSURANCE
Government self-insured; no deductibles. Only actual expenses passed through.	Government self-insured, no deductibles. Only actual expenses passed through.	Contractor obtains $10,000,000/ incident coverage with $25,000 deductible per incident. Per diem charge to government reflects premium and an estimated number of deductibles whether used or not.
LIQUIDATED DAMAGES	LIQUIDATED DAMAGES	LIQUIDATED DAMAGES
No liability.	No liability.	$10,000/day paid to U.S. Government if the vessel does not reach full operating status by 4th day after notification to proceed.

[1] The RRF program has the following phases: Phase I - Acquisition; Phase II - upgrade; Phase III - Deactivation; Phase IV - Maintenance; Phase V - Exercise; Phase VI, Sealift Enhancement Features; and Phase O - operation;

Another industry executive provided the following comments and examples of how these issues could adversely affect a contractor.

"The risk/reward ratio of the Contractor is dramatically and adversely altered from that of a commercial contract or a MARAD GAA, when he takes on a Navy contract. The Contractor's profit is perhaps $50,000 a year per vessel in lay-up. In rare instances the vessel may be called up on short notice for service with the Military Sealift Command to operate for about three months. Under the Navy contract, for a mere additional profit perhaps of $25,000, in round numbers, the Contractor risks the possible loss of hundreds of thousands of dollars per vessel in penalties of one kind or another. For example:

(a) "Off-Hire Liability. If the vessel is placed in an "off-hire" status by the Navy, the Contractor receives no compensation for the days off-hire. The compensation lost is not just the Contractor's overhead, general administrative expenses, which are ongoing, and profit of perhaps $300 per day, but all daily contracted operating costs, which could run in full operational status to as much as $10,000 per day. Off-hire insurance can be obtained, and added to the bid price to the Government, but it does not start to pay out until after the vessel has been off-hire for fourteen days, creating an unavoidable exposure for the Contractor of up to $140,000...."

(b) "Liquidated Damages. When a laid-up vessel is ordered into service by the Navy and is not delivered for service (Full Operating Status "FOS") by the Contractor within the specified period of time (can be as few as four days), and the delay is caused or contributed to by the failure to properly perform or supervise the maintenance and repairs for which the Contractor is responsible, the Contractor then must pay a totally unrealistic and burdensome penalty of $10,000 per day or part thereof for all the time lost until the vessel is available for the Navy's service. This is in addition to the off-hire liability as described above."

(c) "Insurance Liability. Under a General Agency Agreement the Contractor is protected from lawsuits except for gross misconduct or willful negligence, but under the Navy contract he must hold the Government harmless from any liabilities, meaning unlimited exposure; so he must get insurance. The cost of this insurance from $100,000 annually in lay-up to $290,000 in operational status, plus the deductible cost for the

APPENDIX IV

number of accidents that the Contractor guesses he will suffer, is included in the bid price to the Government; the more accidents the Contractor covers, the higher his bid and the lower his chance is to be low bidder. Suppose the Contractor has estimated three accidents per year, and the deductible is $25,000 per accident. Then an inspected and properly tested cargo crane cable parts and snakes across the deck, killing or injuring ten men. The Contractor is immediately liable for a $175,000 payment to cover the extra seven accidents. There are many other types of ruinous accidents which really cannot be controlled by the Contractor."

MARAD also received correspondence from a number of general agents declining to submit proposals in response to the RFP and from others voicing objections because of the impending risk clauses. The following are excerpts from some of this correspondence.

--Respondent A (Current General Agent for 16 RRF Vessels)

"After considerable deliberation and discussion, Respondent A has decided not to respond to the General Agency Agreement solicitation.

The terms/conditions of this solicitation place an unreasonable liability on the General Agent, and such an exposure is too great for us to provide a fixed price offer."

--Respondent B

1. "All risks of private ownership have been placed upon the managers shoulders with none of the benefits of private ownership."

2. "The risk to be assumed by the manager are of such vast proportions it precludes any attempts to reasonable account for them in our offered fee structure."

--Respondent C

"Respondent has decided not to respond to the above for the following reasons:

1. The unprecedented transfer of traditional ship owners risk to the ship manager by MARAD/MSC.

2. The untested legal ramifications and unknown financial impact which will flow from this reversal of roles.

3. Lack of the normal judicial processes to defend against MARAD/MSC who are at once, Judge, Jury and Prosecutor, blessed with unlimited financial resources."

--Respondent D (Current general agent for 13 RRF vessels)

"The off-hire penalty in our view is set too high, and the only way a manager will be able to cover himself will be to put in a high off-hire number for the operational phase. If the vessel succeeds in sailing without any off-hire during this phase of operation, the government has paid a high cost for protection which could have been obtained otherwise."

--Respondent E

"Quite frankly, we feel that the imposing of "Off-Hire" is not in the best interest to this contract and is certainly not cost efficient. It is clearly a departure from the proven and successful practice adhered to by the General Agents in their current contracts.

The imposing of an "Off-Hire" clause is unreasonable and any good manager under these circumstances will either not participate in this program or at least protect himself by increasing his fee and taking out insurance. If available, such insurance will be expensive...."

APPENDIX V

SECTION 11 OF THE MERCHANT SHIP SALES ACT OF 1946, AS AMENDED

(50 U.S.C. 1744)

(a) The Secretary of Transportation shall place in a national defense reserve (1) such vessels owned by the Department of Transportation as, after consultation with the Secretary of the Army and the Secretary of the Navy, he deems should be retained for the national defense, and (2) all vessels owned by the Department of Transportation on June 30, 1950, for the sale of which a contract has not been made by that time, except those determined by the Secretary of Transportation to be of insufficient value for commercial and national defense purposes to warrant their maintenance and preservation, and except those vessels, the contracts for the construction of which are made after September 2, 1945, under the provisions of the Merchant Marine Act, 1936, as amended [46 U.S.C.A. § 1101 et seq.]. A vessel under charter on June 30, 1950, shall not be placed in the reserve until the termination of such charter. Unless otherwise provided for by law, all vessels placed in such reserve shall be preserved and maintained by the Secretary of Transportation for the purpose of national defense. A vessel placed in such reserve shall in no case be used for any purpose whatsoever except that any such vessel may be used for account of any agency or department of the United States during any period in which vessels may be requisitioned under section 902 of the Merchant Marine Act, 1936, as amended [section 1242 of Title 46], and that any such vessel may be used under a bareboat charter entered into pursuant to authority vested in the Secretary of Transportation on July 1, 1950, or granted to the Secretary of Transportation after such date.

(b) Any war-built vessel may be made available by the Secretary of Transportation to any State maintaining a marine school or nautical branch in accordance with the Act of July 29, 1941 (Public Law 191, Seventy-seventh Congress; 55 Stat. 607 [sections 1123a-1123e of Title 34].)